United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-4109

Signed

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

MATTHEW V. BYRNE and ELVIRA C. BYRNE,
Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellee

GORDON P. SCHOPFER and RHONDA F. SCHOPFER,
Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellee

B
p/s

ON APPEAL FROM THE DECISIONS OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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STATEMENT OF THE ISSUE PRESENTED

Whether the Tax Court correctly held that the taxpayers[1/] were not entitled to rely on the "grandfather" clause in Section 167(j)(6)(C) of the Internal Revenue Code of 1954, as amended by the Tax Reform Act of 1969, and, accordingly, could not adopt

1/ Elvira C. Byrne and Rhonda F. Schopfer are parties to this litigation solely because they filed joint returns with their respective husbands for the taxable years in question. In this brief Matthew V. Byrne and Gordon P. Schopfer will be referred to as "taxpayers."

150-percent declining balance depreciation on a used office building acquired after July 24, 1969, where the Court found that the taxpayers' pre-July 24, 1969, proposal to liquidate their controlled corporation and distribute the building to themselves did not constitute a binding written contract as required by Section 167(j)(6)(C).

STATEMENT OF THE CASE

This is an appeal by the taxpayers from the decisions of the United States Tax Court (Judge Tannenwald) determining deficiencies in the total amount of $3,808 in the income taxes of taxpayers Matthew V. Byrne and Elvira C. Byrne for the taxable years 1970, 1971, and 1972, and determining deficiencies in the total amount of $3,624 in the income taxes of taxpayers Gordon P. Schopfer and Rhonda F. Schopfer for the taxable years 1970, 1971, and 1972. (R. 3a, 5a, 6a-9a.)[2/] These two cases were consolidated by order of the Tax Court for purposes of trial, briefing and opinion (R. 2a, 4a), and they have been treated as a consolidated case in the civil appeal scheduling order issued by this Court (Scheduling Order, dated April 22, 1976). The findings of fact and opinion of the Tax Court were filed on December 3, 1975, and are reported at 65 T.C. 473. (R. 38a.) Pursuant to Rule 155 computations filed by the parties, decisions in both cases were entered on January 22, 1976. (R. 3a, 5a.) On April 14, 1976, the taxpayers filed a timely notice of appeal in both cases. (R. 3a, 5a.) The jurisdiction of this Court is invoked pursuant to Section 7482 of the Internal Revenue Code of 1954.

2/ "R." references are to the separately bound record appendix.

The facts, as found by the Tax Court and as shown by the record are as follows:

In 1969 Warron Properties, Ltd., a New York corporation, owned an eight-story office building in Syracuse, New York. (R. 40a.) Taxpayers Matthew V. Byrne and Gordon P. Schopfer, together with two other persons, John J. Costello and Ralph E. Schopfer, each owned one-fourth of the outstanding stock of Warron Properties, Ltd. (R. 40a.) Byrne was the president of the corporation and Costello was its secretary and treasurer. (R. 40a.) On June 6, 1969, Byrne and Costello met with the corporation's accountants to discuss the possibility of liquidating the corporation. (R. 41a.) As a result of that meeting, Byrne prepared a letter, which he sent to Ralph and Gordon Schopfer, outlining the advantages of such a liquidation. (R. 41a, 165a.) The letter stated as follows (id.):

> Enclosed please find copy of the events that will take place as we liquidate the Corporation as of June 30th and carry the property in the form of a partnership through 1973.
>
> In 1969, we will share a $14,500.00 tax loss; in 1970, $23,506.00; in 1971, $17,376.00; in 1972, $11,171.00; and in 1973, $809.00. Thereafter, the partnership will show a profit and, depending upon our situation at that time, we can then transfer the property to a corporation.
>
> We think his is the thing to do and we would hope that you both would approve of it as soon as possible.

Attached to the letter was a schedule comparing the tax consequences of remaining in corporate form with those to be anticipated from the proposed liquidation and transfer of the building to a partner-

ship composed of the four shareholders. (R. 166a.) Thereafter, on June 23, 1969, the four shareholders met to discuss the proposed liquidation. (R. 41a.) Taxpayer Matthew V. Byrne prepared a memorandum of this conference which stated as follows (R. 42a, 167a):

> MEMORANDUM OF CONFERENCE WITH GORDON SCHOPFER, RALPH SCHOPFER, JOHN COSTELLO AND MATTHEW V. BYRNE, JR.
>
> Under date of June 23rd, John Costello, Gordon Schopfer and Ralph Schopfer met to discuss the liquidation. All items were satisfactory with all parties except for the insurance coverage. Mr. Farrington met with us and fully explained the coverage and thereafter we went to lunch, at which time the four men agreed that we should proceed promptly with the liquidation.
>
> Matthew V. Byrne, Jr.

The liquidation was not carried out as of June 30, 1969, as proposed in Byrne's letter to the Schopfers. (R. 165a.) In fact, it was not carried out until December 31, 1969, and the partnership agreement under which the four partners operated the building after the transfer was corrected in ink to reflect the later date. (R. 146a.) Byrne testified that the reason for the failure to complete the liquidation by June 30, 1969, as originally contemplated, was the need to obtain an appraisal of the building before the transfer, in order to establish its value for tax purposes. (R. 190a-191a.) However, the two appraisals which he did obtain prior to the transfer were oral and no written memorandum was made of the appraisers' valuations. (R. 192a-193a.)

The Tax Court held that the taxpayers were not entitled to use 150 percent declining balance depreciation on the building because it was not acquired pursuant to the terms of a written

agreement which was binding on the taxpayers on July 24, 1969, as required by Section 167(j)(6)(C) of the Internal Revenue Code of 1954. (R. 43a-44a, 48a-51a.) The court held that the memorandum of the June 23, 1969, meeting of the shareholders' meeting of Warron Properties, Ltd., did not constitute a written agreement by the shareholders to liquidate the corporation and that it was merely a record of the events that took place at the meeting. (R. 47a-48a.) The Court went on to hold that even if this memorandum were accorded the status of a written contract, such an agreement would not qualify for the exemption in Section 167(j)(6)(C) because it was not a bona fide purchase agreement negotiated at arm's length. (R. 49a-52a.) As the court pointed out, the taxpayers were not under any obligation to pay for the property, they merely accepted it as a liquidating dividend from the corporation. (R. 49a-50a.) The record was clear that the only purpose for the proposed liquidation of the corporation was to secure the very tax advantage which Congress enacted Section 167(j) of the Code to eliminate, namely the use of accelerated depreciation deductions on real property as a means for sheltering other income. (R. 50a-54a.) Accordingly, the Court held that Section 167(j)(6)(C) did not apply, and the taxpayers were limited to straight line depreciation on the building, as contended by the Commissioner. (R. 42a-44a, 53a-54a.) From this adverse decision the taxpayers bring this appeal.

SUMMARY OF ARGUMENT

The Tax Court properly rejected the taxpayers' contention that they were entitled to use 150-percent declining balance depreciation on a used office building which they acquired after July 24, 1969, despite the restriction to straight line depreciation contained in Section 167(j)(4) of the Code. Although the taxpayers claimed that they were entitled to relief from this restriction under the exemption provided by Section 167(j)(6)(C) for property acquired under a written contract which was binding on the taxpayers on July 24, 1969, and at all times thereafter, the purported contract on which they relied did not impose any obligations upon them whatsoever. Rather it was a proposed course of conduct by four persons with identical economic interests, including the taxpayers, to dissolve a corporation, which they collectively owned and controlled, and distribute its assets to themselves.

Both the Regulations and the legislative history show that the purpose of Section 167(j)(6)(C) was to provide a carefully limited relief measure for taxpayers who had entered into contractual obligations for the acquisition of used real property in reliance on the anticipated tax benefits to be gained from the depreciation deductions. Accordingly, the Regulations require that a taxpayer must be subject to liability for damages in more than a nominal amount if he fails to perform under the contract. Such liability cannot exist in the present case, since there is no one with a substantial economic interest adverse to that of the taxpayers and their fellow shareholders who could claim damages for their failure to liquidate their wholly owned corporation. The mere

possibility that the taxpayers might be sued to compel them to go through with the liquidation, which they intended to do anyway for tax purposes, does not transform the proposed liquidation into a pre-July 24 binding obligation. In fact, the four shareholders in this case ended up owning the same building in the same proportions as they had before the transaction, only it was then held in the form of a partnership rather than a corporation. The Tax Court was clearly right in holding that this type of transaction did not come within the intent of Congress in enacting Section 167(j)(6)(C) to provide relief to taxpayers with pre-existing contractual commitments.

The conference memorandum prepared by Matthew V. Byrne, Jr. on June 24, 1969, wholly fails to qualify as a binding written contract for purposes of Section 167(j)(6)(C) and the Regulations thereunder. Even assuming that the memorandum satisfies the formal requirements of New York law and can qualify as the minutes of a meeting of the shareholders of Warron Properties, Ltd., that does not make these minutes binding on the taxpayers as individuals. Moreover, as a "contract" it is seriously deficient in every respect. It is not signed by anyone, it does not contain any contractual promises to do anything, and it is silent as to when the proposed liquidation should take place. Even if any one of these deficiencies were not fatal to the existence of a binding contract, collectively they would leave a New York state court with nothing to enforce, and the Tax Court properly rejected this memorandum as a binding written contract for purposes of Section 167(j)(6)(C).

ARGUMENT

THE TAX COURT CORRECTLY CONCLUDED THAT THE BUILDING INVOLVED IN THIS CASE WAS NOT ACQUIRED BY THE TAXPAYERS PURSUANT TO A WRITTEN CONTRACT BINDING ON THE TAXPAYERS ON JULY 24, 1969, AND AT ALL TIMES THEREAFTER, AND HENCE THE TAXPAYERS WERE NOT ENTITLED TO USE ACCELERATED DEPRECIATION

Section 167(a) of the Internal Revenue Code of 1954, Appendix, infra, provides that a "reasonable allowance" for exhaustion, and wear and tear, including obsolescence, shall be allowed as a depreciation deduction in the case of property used in the taxpayer's trade or business or property held for the production of income. When the 1954 Code was enacted, the depreciation allowance was liberalized substantially by the addition of Section 167(b) to the Code, which permitted the use of the declining balance method and the sum of the years-digits method of computing depreciation. Compare Section 23(l) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.), with Section 167(a) and (b) of the Internal Revenue Code of 1954. With respect to certain depreciable real property, as defined in Section 1250(c) of the 1954 Code (26 U.S.C.), however, the privilege of using the so-called accelerated depreciation methods -- namely declining balance depreciation and sum of the years-digits depreciation -- was curtailed or eliminated by the enactment of the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, Sec. 521(a) which added Section 167(j), Appendix, infra, to the Code. In particular, Section 167(j)(4) restricts the purchaser of used Section 1250 property acquired after July 24, 1969, to straight line depreciation on such property. The House Report on the bill which

ultimately became the Tax Reform Act of 1969 states that the purpose of this restriction on the depreciation of used real property was "to eliminate the repeated sale and resale of property for the purpose of tax minimization." H. Rep. No. 91-413, Part 1, 91st Cong. 1st Sess. pp. 166-167 (1969-3 Cum. Bull. 200, 304.)

The stipulated facts in this case establish that the taxpayers, as partners, acquired a used office building after July 24, 1969. (R. 43a, 58a, 60a.) Thus, they come within the terms of the restriction imposed by Section 167(j)(4), and they are required to use straight line depreciation on this building, unless they can establish their right to relief under the special "grandfather" exception provided for pre-existing contractual obligations by Section 167(j)(6)(C).[3/] That section provides that the restrictions imposed by Section 167(j)(4)--

> shall not apply in the case of section 1250 property acquired after July 24, 1969, pursuant to a written contract for the acquisition of such property or for the permanent financing thereof, which was, on July 24, 1969, and at all times thereafter, binding on the taxpayer.

3/ Section 167(j)(6)(C) was added to the bill by the Senate Finance Committee. S. Rep. No. 91-552, 91st Cong., 1st Sess., p. 213 (1969-3 Cum. Bull. 423, 558.) The purpose of the amendment was to provide an exception for pre-existing contracts to purchase used realty similar to the exception which had been allowed for pre-existing contracts for the construction or permanent financing of new real prope..y under the House bill. Compare, Section 167(j)(3) with Section 167(j)(6)(C). The July 24, 1969, cutoff date in Section 167(j)(6)(C) was apparently adopted by the Senate to conform to the cutoff date used by the House in Section 167(j)(3) with respect to contracts for new construction; the House bill (H.R. 13270) containing these new restrictions on real estate depreciation was introduced on the floor of the House and printed in the Congressional Record on August 1, 1969. 115 Cong. Rec., Part 16, pp. 21,781, 21,814, 21,871. The Report of the Committee on Ways and Means on H.R. 13270, dated August 2, 1969, states that the proposed changes in real estate depreciation

The Commissioner has issued Regulations which prescribe in detail the requirements for exemption under Section 167(j)(6)(C). Treasury Regulations on Income Tax (1954 Code), §§ 1.167(j)-4(b) and (c), Appendix, infra, and 1.167(j)(7)(c) (26 C.F.R.). As the Tax Court pointed out (R. 49a), in order to qualify as a "binding contract" under Section 167(j)(6)(C) the contract in question must be "a bona fide agreement negotiated at arm's length." Treasury Regulations on Income Tax (1954 Code), § 1.167(j)-4(b)(3)(i).

The letter and conference memorandum on which the taxpayers rely in this case (Br. 4-6), does not qualify under Treasury Regulations on Income Tax (1954 Code), § 1.167(j)-4(b), because it is not an arm's length bargain within the meaning of those Regulations. Rather, these documents at best evidence an intention of four individuals, including the taxpayers, all of whom had identical economic interests in the property, to liquidate their corporation and distribute the assets of the corporation to themselves. (R. 40a-41a.) The transaction was solely tax motivated (R. 49a-50a), and the participants simply ended up owning the same office building, in the same proportions, through a partnership instead of a corporation. (R. 57a-58a.) And even if the memorandum prepared by taxpayer Matthew V. Byrne, Jr.

3/ (continued)
contained in the bill "are to apply with respect to taxable years ending after July 24, 1969." H. Rep. No. 91-413, Part I, supra, p. 167. This choice of effective date appears to reflect a Congressional concern for the protection of taxpayers having existing contractual commitments, while at the same time preventing a scramble for shelter under the "grandfather" clause of the bill after the proposed new restrictions were announced to the public.

could somehow be construed as constituting a written agreement, as the taxpayers contend (Br. 6-11), and even if that agreement might be enforceable as among the four participants (Br. 7-8), the essential element of an arm's length bargain by parties with adverse economic interests would still be missing.

Under New York law, the shareholders of a corporation have a right to dissolve the corporation and distribute the assets to themselves after paying or providing for the debts of the corporation. Business Corporation Law, McKinney's Consol. Laws of N.Y. Ann., §§ 1001 and 1005(a). But such a voluntary dissolution clearly was not within the intent of Congress in providing an exemption from the restrictions of Section 167(j)(4) for taxpayers whose obligations were fixed by a pre-existing binding written contract. The legislative history shows that Congress was aware that investor participation in real estate ventures was frequently solicited through promises of a tax shelter arising from the depreciation deductions on the real property. H. Rep. No. 91-413, Part 1, supra, p. 165 (1969-3 Cum. Bull., p. 303); S. Rep. No. 91-552, supra, p. 212 (1969-3 Cum. Bull., p. 557.) Depriving such investors of the anticipated tax benefits of such a venture after they had assumed binding obligations in reliance on those benefits, would have taken away an advantage already bought and paid for, and might in some cases have inflicted substantial economic hardship on such investors.

The Regulations make clear that only a contract under which the taxpayer has assumed substantial obligations qualifies as a binding contract for purposes of Section 167(j)(6)(C). In

particular, under Treasury Regulations on Income Tax (1954 Code), § 167(j)-4(b)(4), the taxpayer must be subject to liability for damages if he fails to perform under the contract, and if such liability is limited by the terms of the contract, the amount of the liability must be more than nominal. The taxpayers here have not introduced any evidence to show the existence of any party with interests adverse to theirs who would be in a position to compel them to respond in damages if they failed to carry out their agreement to liquidate Warron Properties, Ltd. Indeed, all four parties to the transaction had an identical financial interest in the transaction, namely the desire to obtain a 25-percent share of the substantial tax losses which were projected for the building in each of five taxable years following its transfer to them as partners. (R. 41a.) This provision of the Regulations would be meaningless if, as the taxpayers appear to contend (Br. 7), they could carry their burden of proof on the issue of whether there was a binding contract merely by showing that there was a theoretical possibility that they could be sued to enforce their proposed liquidation of Warron Properties, Ltd. The Regulations require that the taxpayers' obligations under the contract must be real and substantial, and that their contractual promises must be enforceable by more than nominal damages in an action for breach of contract. Treasury Regulations on Income Tax (1954 Code), § 1.167(j)-4(b)(4). The mere possibility that the taxpayers might be sued to compel them to go through with the voluntary liquidation of a corporation, which they were planning to do anyway, does not comply with the requirements of the

Regulations or the intent of Congress, in authorizing a limited sanctuary for prior binding contractual arrangements when it eliminated the very tax advantage which the taxpayers were trying to obtain.[4/]

Finally, the Tax Court correctly rejected (R. 46a-48a) the taxpayers' argument that the conference memorandum prepared by Matthew V. Byrne, Jr., on June 24, 1969 (R. 167a), constitutes the written contract required by the Section 167(j)(6)(C). The formal requirements which must be satisfied before a transaction can qualify under Section 167(j)(6)(C) are set out in Treasury Regulations on Income Tax (1954 Code), § 1.167(j)-4(b)(3), which states that:

> An agreement shall be considered as a contract binding on the taxpayer, * * * only if such agreement is in writing, constitutes a contract under applicable State or local law, and is enforceable against the taxpayer under such law.

It is quite unlikely that the New York courts would enforce any contractual obligations whatever against the taxpayers on the basis of Byrne's memorandum. In the first place, the memorandum does not contain any contractual promises made by the taxpayers; it merely records a consensus reached to proceed promptly with the liquidation of Warron Properties, Ltd. (R. 167a.) Even assuming, as the taxpayers contend (Br. 9), that this document

4/ Similarly, Treasury Regulation on Income Tax (1954 Code), § 1.167(j)-4(b)(6) cited by the taxpayers (Br. 11-12), allows a contract with undetermined terms or conditions to be considered as binding on the taxpayer only if the determination of such terms or conditions is not within the unrestricted control of the taxpayer. Here, the resolution of any ambiguities which may have existed with respect to the terms of the proposed liquidation was clearly within the unrestricted control of the taxpayers and their fellow shareholders in Warron Properties, Ltd., none of whom had any interest adverse to that of the taxpayers in this transaction.

constitutes the minutes of a meeting of the shareholders of Warren Properties, Ltd., it does not thereby become a written agreement binding on the taxpayers. Douchkess v. Campbell, 64 N.Y.S. 2d 554 (Sup. Ct. 1946), aff'd 272 App. Div. 795, 71 N.Y.S. 925 (1947), appeal denied, 272 App. Div. 961, 72 N.Y.S. 2d 830 (1947). It reflects only the corporate act of liquidation (see Business Corporation Law, McKinney's Consol. Laws of N.Y., Ann., § 1001) and not the individual acts and undertakings of the taxpayers.5/

Moreover, as the Tax Court noted (R. 46a) the Byrne memorandum lacks all the formal requisites of a binding contract. It was not signed by anyone, (see the New York statute of frauds, General Obligations Law, McKinney's Consol. Laws of N.Y. Ann., § 5-701.), contains no express promises by anyone, and merely records the decision by four named individuals, including the taxpayers, to liquidate Warron Properties, Ltd. The capacity in which these four individuals purported to act is nowhere set out, nor is there any indication of the time when the liquidation was supposed to take place. Even assuming that the absence of any one of these factors would not be fatal to the existence of a binding written contract for purposes of Section 167(j)(6)(C), collectively their absence would leave a New York state court with nothing to enforce.

5/ Taxpayers' reliance on Frankowski v. Palermo, 47 App. Div. 2d 579, 363 N.Y.S. 2d 159 (1975) is misplaced. In that case, the plaintiff was held to be entitled to rely on the minutes of a directors' meeting as evidence of the corporate act of issuing shares to its president for less than par value. Here, the taxpayers seek to rely on the minutes as evidence that the agreement to liquidate was binding upon them. Obviously, a corporation cannot, by its minutes or otherwise, undertake an obligation binding upon someone else, in the absence of evidence of agency or some other proper authorization. See, Douchkess v. Campbell, supra.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be affirmed.

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JULY, 1976.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 30th day of July, 1976, in an envelope, with postage prepaid, properly addressed to him as follows:

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 167. DEPRECIATION.

(a) General Rule.--There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

(j) [as added by Sec. 521(a), Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487] Special Rules for Section 1250 Property.--

(1) General rule.--Except as provided in paragraphs (2) and (3), in the case of section 1250 property, subsection (b) shall not apply and the term reasonable allowance as used in subsection (a) shall include an allowance computed in accordance with regulations prescribed by the Secretary of his delegate, under any of the following methods:

(A) the straightline method,

(B) the declining balance method, using a rate not exceeding 150 percent of the rate which would have been used had the annual allowance been computed under the method described in subparagraph (A), or

(C) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in subparagraph (B).

Nothing in this paragraph shall be construed to limit or reduce an allowance otherwise allowable under subsection (a) except where allowable solely by reason of paragraph (2), (3), or (4) of subsection (b).

(2) Residential rental property.--

(A) In General.--Paragraph (1) of this subsection shall not apply, and subsection (b) shall apply in any taxable year, to a building or structure--

(i) which is residential rental property located within the United States or any of its possessions, or located within a foreign country if a method of depreciation for such property comparable to the method provided in subsection (b)(2) or (3) is provided by the laws of such country, and

(ii) the original use of which commences with the taxpayer. In the case of residential rental property located within a foreign country, the original use of which commences with the taxpayer, if the allowance for depreciation provided under the laws of such country for such property is greater than that provided under paragraph (1) of this subsection, but less than that provided under subsection (b), the allowance for depreciation under subsection (b) shall be limited to the amount provided under the laws of such country.

(B) Definition.--For purposes of subparagraph (A), a building or structure shall be considered to be residential rental property for any taxable year only if 80 percent or more of the gross rental income from such building or structure for such year is rental income from dwelling units (within the meaning of subsection (k)(3)(C)). For purposes of the preceding sentence, if any portion of such building or structure is occupied by the taxpayer, the gross rental income from such building or structure shall include the rental value of the portion so occupied.

(C) Change in method of depreciation.--Any change in the computation of the allowance for depreciation for any taxable year, permitted or required by reason of the application of subparagraph (A), shall not be considered a change in a method of accounting.

(3) Property constructed, etc., before July 25, 1969.--Paragraph (1) of this subsection shall not apply, and subsection (b) shall apply, in the case of property--

(A) the construction, reconstruction, or erection of which was begun before July 25, 1969, or

(B) for which a written contract entered into before July 25, 1969, with respect to any part of the construction, reconstruction, or erection or for the permanent financing thereof, was on July 25, 1969, and at all times thereafter, binding on the taxpayer.

(4) Used section 1250 property.--Except as provided in paragraph (5), in the case of section 1250 property acquired after July 24, 1969, the original use of which does not commence with the taxpayer, the allowance for depreciation under this section shall be limited to an amount computed under--

(A) the straight line method, or

(B) any other method determined by the Secretary or his delegate to result in a reasonable allowance under subsection (a), not including

(i) any declining balance method,

(ii) the sum of the years-digits method, or

(iii) any other method allowable solely by reason of the application of subsection (b)(4) or paragraph (1)(C) of this subsection.

(5) Used residential rental property.--In the case of section 1250 property which is residential rental property (as defined in paragraph (2)(B)) acquired after July 24, 1969, having a useful life of 20 years or more, the original use of which does not commence with the taxpayer, the allowance for depreciation under this section shall be limited to an amount computed under--

(A) the straight line method,

(B) the declining balance method, using a rate not exceeding 125 percent of the rate which would have been used had the annual allowance been computed under the method described in subparagraph (A), or

(C) any other method determined by the Secretary or his delegate to result in a reasonable allowance under subsection (a), not including--

(i) the sum of the years-digits method.

(ii) any declining balance method using a rate in excess of the rate permitted under subparagraph (B), or

(iii) any other method allowable solely by reason of the application of subsection (b)(4) or paragraph (1)(C) of this subsection.

(6) Special rules.--

(A) Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided in paragraphs (5), (9), (10), and (13) of section 48(h) shall be applied for purposes of paragraphs (3), (4), and (5) of this subsection.

(B) For purposes of paragraphs (2), (4), and (5), if section 1250 property which is not property described in subsection (a) when its original use commences, becomes property described in subsection (a) after July 24, 1969, such property shall not be treated as property the original use of which commences with the taxpayer.

(C) Paragraphs (4) and (5) shall not apply in the case of section 1250 property acquired after July 24, 1969, pursuant to a written contract for the acquisition of such property or for the permanent financing thereof, which was, on July 24, 1969, and at all times thereafter, binding on the taxpayer.

* * *

Treasury Regulations on Income Tax (1954 Code) (26 U.S.C.)

§ 1.167(j)-4 Property constructed, etc., before July 25, 1969.

* * *

(b) Binding contract for construction--(1) General rule. Section 167(j)(3)(B) provides that section 167(j)(1) shall not apply and section 167(b) shall apply (subject to the limitations contained in section 167(c) in the case of any section 1250 property for which a written contract with respect to any part of the construction, reconstruction, or erection, or for a substantial portion of the permanent financing, was on July 25, 1969, and at all times thereafter, binding on the taxpayer. A contract for construction, reconstruction, or erection shall not be considered a binding contract under section 167(j)(3)(B) unless such contract meets the requirements of subparagraphs (2) through (7) of this paragraph. A contract with respect to permanent financing shall not be considered a binding contract for purposes of section 167(j)(3)(B), unless such contract meets the requirements of paragraph (c) of this section.

* * *

(3) Legal formality. (i) An agreement shall be considered as a contract binding on the taxpayer, for purposes of this paragraph, only if such agreement is in writing, constitutes a contract under applicable State or local law, and is enforceable against the taxpayer under such law. A contract which does not represent a bona fide agreement negotiated at arm's length shall not be considered a binding contract under this paragraph. In any case where a person that is named as a party to the contract is acting solely as a mere nominee, the real party in interest shall be considred a party to the contract.

* * *

(4) Liability for and amount of damages. A contract will not be considered to be binding upon the taxpayer for purposes of this paragraph unless (i) the taxpayer's failure to perform would subject him or his property to liability for damages or to a forfeiture of a down payment or a deposit, and (ii) the amount of such liability for damages is not limited by the terms of the contract or, if contractually limited, the liability or forfeiture is more than nominal. If the deposit, liquidated damages, or down payment is consistent with the normal commercial practices in the locality, the contract may qualify under this paragraph. It is not required that the taxpayer be subject to personal liability for such damages. For example, if the taxpayer's liability is limited and enforceable only against the taxpayer's property, the contract may still qualify under this subparagraph.

* * *

(6) Contract with undetermined terms or conditions. A contract may be binding upon the taxpayer under this paragraph even if some of its terms are to be determined at a date later than July 25, 1969, provided that the determination of such terms is not within the unrestricted control of the taxpayer, and such terms are in fact subsequently determined. Similarly, a contract may be binding upon the taxpayer under this paragraph even if it is subject to the happening of certain contingencies which have not occurred by July 25, 1969, provided that the happening of such contingencies is not within the unrestricted control of the taxpayer, and the contingencies in fact occur.

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